

Internal Revenue Service

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Person To Contact:
 , ID No.

Telephone Number:

Refer Reply To:
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Date:
January 11, 2016

X =

Date 1 =

State =

Date 2 =

Date 3 =

Trust =

A =

Date 4 =

Trust 2 =

Date 5 =

n =

New Trusts =

Dear _____ :

This responds to a letter dated August 31, 2015, and supplemental information, submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and representations made, X was incorporated on Date 1 under the laws of State. Effective Date 2, X elected to be taxed as an S corporation under § 1362 of the Code. Prior to Date 3, Trust was a grantor trust wholly owned by A and was an eligible shareholder of X. On Date 3, A died and Trust ceased being a grantor trust. Trust qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for two years from A's date of death. However, a timely election to treat Trust as an electing small business trust ("ESBT") after this period was not made. Trust became an ineligible shareholder of X, causing X's S corporation election to terminate, effective Date 4. On or about Date 4, Trust was reconstituted as Trust 2 and Trust 2 was considered the sole shareholder of X during the period commencing on Date 4 and ending on Date 5.

Effective Date 5, pursuant to the trust agreement governing both Trust and Trust 2, n separate trusts were created, one for each of the current income beneficiaries, with the intention that each trust would qualify as a qualified small business trust ("QSST") under § 1361(d) of the Code (the "New Trusts"). Each beneficiary of the New Trusts authorized X to file a QSST election on its behalf with the Service effective Date 5.

X represents that since Date 2, it has filed its federal income tax returns consistent with being an S corporation. X represents that its S corporation election termination was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Trust 2 and X represent that Trust 2 would have qualified as an ESBT since Date 4 and the New Trusts have qualified as QSSTs since Date 5. Trust 2 has agreed to file amended returns consistent with being an ESBT. Further, X represents that X and its shareholders will make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code that may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(c)(2)(A) provides, in relevant part, that, for purposes of § 1361(b)(1)(B), the following trusts may be shareholders of an S corporation: (i) a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States; (ii) a trust that was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner’s death; and (iii) an ESBT.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) -- (A) such trust shall be treated as a trust described in § 1361 (c)(2)(A)(i), (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under paragraph (2) is made, and (C) for purposes of applying §§ 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

Section 1361(d)(2) provides that a beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have § 1361(d)(1) apply. An election under § 1362(d)(2) shall be made separately with respect to each corporation the stock of which is held by the trust.

Section 1361(d)(3) defines “qualified subchapter S trust” as a trust, (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1361(e)(1)(A) provides that an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4) or (5) , or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) provides that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(iii) provides that the election must be filed within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election inadvertently terminated within the meaning of § 1362(f) on Date 4 due to the trustee's failure to make an ESBT election for Trust 2. Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4. Trust 2 it will be treated as an ESBT from Date 4 to Date 5 and the New Trusts will be treated as QSSTs from Date 5. This conclusion is reached provided that X's S corporation election and the New Trusts' QSST elections were otherwise valid and have not otherwise terminated under § 1362(d).

This ruling is contingent upon, within 120 days from the date of this letter, the trustee filing with the appropriate service center an election to treat Trust 2 as an ESBT effective from Date 4 to Date 5. This ruling is also contingent upon the trustee filing, within 120 days from the date of this letter, any amended returns that may be required to conform with Trust 2's treatment as an ESBT from Date 4 to Date 5. A copy of this letter should be attached to the ESBT election and the amended returns.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, Trust 2's eligibility to be an ESBT, or the New Trusts' eligibility to be QSSTs.

This ruling is directed only to the taxpayer that requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 3
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: